

Statement of Jamie Woodward
New York Department of Taxation and Finance

Thank you for the opportunity to appear before you today. I am Jamie Woodward, Acting Commissioner of the New York State Department of Taxation and Finance. First, I want to express to the IRS the support and enthusiasm that I and my colleagues in tax administration in New York have as the agency takes steps to secure long-overdue regulation of the tax return preparer industry.

In recent years, we in New York observed that the tax preparation field was fast becoming a lucrative market for unscrupulous individuals – many with absolutely no background or experience in taxation. Anyone in New York, regardless of education, experience, training, or even criminal history, can call themselves a preparer and charge the public for the services they provide. Nearly 60% of New York personal income tax returns are prepared with the assistance of someone who is paid for the service. These preparers are uniquely situated to influence taxpayer behavior and become a powerful force behind taxpayers' decisions to voluntarily comply with tax laws or, conversely, to commit tax fraud and other criminal acts. Yet there are no state or national standards under which these individuals and businesses operate.

In New York, we are in the first stages of developing minimum qualifications and standards for this industry and we look forward to working with our colleagues at the IRS to effect meaningful change. Just this past year, Governor Paterson and our Legislature directed my Department to begin to register tax preparers who are not otherwise regulated as licensed accountants or attorneys. The legislation also directs the Tax Commissioner to chair a task force of government and industry representatives, including the IRS, and to make recommendations for minimum education and licensing standards for all tax preparers operating in New York. We are actively organizing this task force now; its findings and recommendations are due to our Legislature by 2012. In response to what appeared to be a growing culture of creative tax avoidance fueled by unscrupulous tax preparers, our Department in recent years has devoted significant resources to investigating and prosecuting these preparers. To get a clear view of the extent of the problem, we borrowed investigative techniques more commonly used in rackets investigations – we went undercover. In less than two years, we conducted nearly two hundred covert operations in which our agents posed as taxpayers seeking to hire tax professionals to prepare income or sales tax returns. While our selection of preparers would not be considered random in the scientific sense, we did attempt to select preparers from across a broad spectrum of the community.

Our findings revealed an epidemic of unethical and criminal behavior by these tax preparers. In the 20 months since we began this project we arrested more than 20 preparers and secured 13 convictions. Of course, our investigations are continuing and additional arrests are anticipated. Many of the preparers in our ongoing investigations are cooperating and providing evidence against their clients and others.

Our investigation uncovered fraud by preparers of all types, from store-front operations to licensed, professional CPAs. All used their knowledge of the tax law and tax administration to operate as fraud coaches to help our undercover agents cheat without getting caught. There was nothing subtle about these preparers' sales pitches or their

instructions. One told us he was going to give us an "education" in how to hide our money without getting caught. Another said he specialized in preparing "plain vanilla" returns: where taxpayers can cheat without triggering an audit. Many of them told us that we wouldn't get caught if we didn't file and, when we decided to file anyway, they coached us to evade taxes by hiding or destroying our business records, creating new or false records, or by hiding our cash, lying about our income or inflating and creating our expenses.

The returns these preparers created fully reflected their willingness to cheat and encourage others to cheat. All appeared to promote the concept that the calculated risk to cheating was low and full compliance was optional. One preparer suggested that we could get away with reporting only one-tenth of our income. Another - - a CPA - - gave us a choice of paying 25% of the tax we owed, 50%, 75%, or the full tax. One joked that he would use his "magic pencil" to create a false return, and several preparers told us that we could get away with reporting only our credit card sales and not to report any cash transactions on sales tax returns.

In addition to investigating preparers who are fraud coaches, we are also investigating tax preparers who run or facilitate refund mills. These operations create and file thousands of fictional tax returns each year, often taking advantage of less educated, unsuspecting taxpayers and putting them at risk. Our investigators, working with the IRS, have uncovered preparers who "sell" dependents, create and/or steal identities, and then forge documents to escape detection on audit. Through the use of predictive modeling and other audit selection tools, we have been able to identify questionable preparers whose returns we monitor and screen very carefully. Not only has this saved New York taxpayers hundreds of millions of dollars in fraudulent refunds we denied, but it has also helped us initiate criminal investigations and prosecute unscrupulous preparers as a result.

New York recognizes the need to bring oversight to the preparer industry and, as I mentioned, we are starting a registration process. Understanding the states' perspectives and providing a national structure of minimum requirements will go a long way to protect both state and federal revenues and the taxpaying public. It will also head off any potential patchwork that could result if states seek individual solutions. All consumers across the country - - consumers who seek to comply with state and federal tax laws - - deserve the knowledge that our tax preparers are trained and educated in their field.

As to our specific suggestions regarding the development of a national program to regulate the preparer community, I offer the following.

First, we strongly suggest that the IRS register all tax preparers, including CPAs and attorneys. Each preparer should be given a unique registration/license number and pertinent registration information (name, address, registration/license number) should be made public. Further, the IRS should promote data matching and information sharing with and between States regarding investigations or concerns regarding incompetent or unscrupulous preparers. Minimum competency standards should be developed and thought given to requiring continuing education.

Consideration should be given to regulating the terms of refund anticipation loans through the regulation of the preparers themselves. Finally, and perhaps the most

difficult, a public education campaign as to the importance of dealing with a reputable preparer is essential.

Whether through enforcement actions or cooperation in creating a much-needed regulatory scheme, New York State stands ready to work with the federal government to achieve meaningful oversight of the tax preparation industry.

Thank you.